United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-5041

In The

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In the Matter of

Robert A. Martin a/k/a R. Allan Martin a/k/a Robert Allan Martin,

Bankrupt-Appellant.

Appeal From the United States District Court For the Southern District of New York, Honorable Edmund L. Palmieri, District Judge

BRIEF FOR BANKRUPT-APPELLANT ROBERT A. MARTIN

HOFHEIMER GARTLIR GOTTLIEB & GROSS
Attorneys for Bankrupt-Appellant Robert A. Martin
100 Park Avenue
New York, New York 10017
(212) 725-0400

(10257)

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STATEMENT OF THE ISSUES

There are three pertinent issues on this appeal:

(1) Were the records of the bankrupt's personal corporation examined by the trustee's accountant? If not, should they have been examined on the ground that they were adequate substitutes for the bankrupt's personal records?

(2) Was the referee's decision that the loss of the bankrupt's personal records did not constitute a sufficient excuse for their non-production a finding of fact or a conclusion of law? If the latter, was the conclusion of law erroneous?

(3) Were the numerous delays in this proceeding intended to pressure the bankrupt and did they unduly prejudice him?

PRELIMINARY STATEMENT

This is an appeal from a decision by Referee Asa Herzog, affirmed by District Judge Edmund L. Palmieri, that the bankrupt Robert A. Martin was not entitled to a discharge. The sole ground for denial was that the bankrupt failed to comply with §14(c)(2) of the Bankruptcy Act which provides in pertinent part:

> "(c) The court shall grant the discharge unless satisfied that the Bankrupt has . . . (2) . . . failed to keep or preserve books of account and records, from which his financial condition and business transactions might be ascertained. . . ."

The bankrupt had shipped to a warehouse for delivery to the trustee both his personal records and those of his corporation, Robert A. Martin Associates, Inc. An essential part of the personal records was lost in transit but the referee, without citing any authority, rejected this excuse as "not acceptable." (351a). As for the corporate records, the referee held that these were insufficient for two reasons. First, he stated that the trustee's accountant had "examined" these records (346a). Second, he stated that the corporate records could not be used to explain transactions which occurred after the corporation had "ceased doing business" (352a-353a).

The District Court affirmed the denial of discharge for essentially the same reasons given by the referee. Also, the District Court held that the bankrupt had not been unduly prejudiced by the long delays in the proceedings (366a-367a).

STATEMENT OF FACTS

The debts of this bankrupt arose between 1961 and 1963 (196a). During this period, the bankrupt was a majority stockholder and principal officer of Robert A. Martin Associates, Inc., a corporation which was a registered broker-dealer in securities (190a). He personally engaged in no business other than that of his corporation through which he conducted an extensive personal account (~~190a, 193a~~ 193a, 196a).

Although the bankrupt did not maintain a ledger for his personal transactions (211a), all of these purchases and sales were included in his corporation's general ledger (212a). In addition, the bankrupt kept many other records, including cancelled checks, stock brokerage confirmation slips, brokerage statements, credit and debit memos from stock factoring companies, bank statements, income tax returns, paid bills, contracts, letter agreements and correspondence (197a-198a).

After encountering severe financial difficulties, the bankrupt filed his petition in bankruptcy on March 4, 1965 (1a). At that time most of his records, as well as those of his corporation, were shipped to a warehouse (200a). The bankrupt instructed the warehouse to deliver all these records to the trustee (203a). However, the bankrupt's checkbook stubs for 1960 through 1963, which to his knowledge had been at the warehouse and were shipped to the trustee, were not received by the trustee or his agents (219a). The bankrupt attempted to locate these missing documents at the office of the trustee's accountant but was unsuccessful (271a). He repeatedly offered to explain all of his financial transactions to the trustee but these offers were ignored (213a).

The trustee did receive an extensive number of documents, and receipts were signed by either him or one of his agents (202a, 203a). Among these documents were the records of Robert A. Martin Associates, Inc. which included a ledger containing all of the bankrupt's purchases and sales as well as

every transaction between the bankrupt and his corporation (221a, 221a). However, the trustee's accountant glanced only perfunctorily at these records and made no attempt to examine them generally ~~(97a, 179a)~~ (97a, 170a).

More than three and a half years after the bankrupt filed his petition, the trustee objected to his discharge (5a). Although he had disregarded the bankrupt's comprehensive corporate records as well as the bankrupt's repeated offers to clarify any item (212a, 213a) ~~(179a, 214a)~~, the trustee's ground for objection was that the bankrupt's financial condition and transactions could not be explained adequately from his books and records.

At the hearing in 1971, the bankrupt was asked to identify, without the aid of records, transactions which had occurred in the early 1960's (239a). Obviously, this was an almost insuperable task.

The referee denied the bankrupt his discharge (9a) and an appeal to the District Court was taken from the referee's decision (10a).

The District Court affirmed in a decision dated October 7, 1976 (Palmieri, J.), holding that (1) the referee's decision that the bankrupt had the duty of insuring the trustee's receipt of the bankrupt's personal records was a finding of fact, and not a conclusion of law (364a); (2) even if the referee had erred in his statement that the trustee's accountant had examined the bankrupt's corporate records, such records were not adequate substitutes for his personal records (365a); (3) the bankrupt was not unduly prejudiced by the long delays in the proceeding (366a, 367a).

The District Court having affirmed the referee's denial of discharge, this appeal was taken.

ARGUMENT

Point I

The bankrupt should not be denied his discharge because the trustee failed to examine his corporate ledger which was an adequate substitute for his personal records.

In *In re Sandow*, 59 F. Supp. 782, 784 (S.D.N.Y. 1944), *aff'd*, 151 F.2d 807 (2nd Cir. 1945), the court stated that when a bankrupt's corporate records are adequate substitutes for his personal records they are acceptable. In the case at bar the referee accepted the above rule of law but held that the bankrupt's corporate records were not adequate substitutes for two reasons. First, the referee stated that the trustee's accountant, who had been unable to piece together the bankrupt's financial condition, had "examined" the records of Robert A. Martin Associates, Inc. (~~448a~~ 346a). In his appeal the bankrupt disputed the above finding, referring the District Court to the following testimony of the trustee's accountant:

> "I made no real examination of the [corporate] records. I didn't go into them. I didn't look at them generally." (170a).

The District Court implicitly acknowledged the referee's blatant error in its discussion of the referee's chronological reasons for holding that the bankrupt's corporate records were inadequate substitutes:

> "The bankrupt testified that Robert A. Martin Associates ceased doing business in late 1962 or early 1963, that it was in liquidation at that time, and that it engaged in no significant loan or securities transactions after 1962. Consequently, the referee found that the corporate records would be inadequate to explain transactions after 1962 . . . .Even if the referee

> erred in finding that the trustee's accountant examined the corporate records, there is still no evidence that the corporate records contained the necessary data pertaining to post-1962 transactions." (365a).

In this statement the District Court makes the same error that the Bankruptcy Court made — assuming that because the bankrupt did no file his petition until 1965, he was engaging in significant transactions until that time. In fact, however, the referee's *own* chart indicates that over 93% of Mr. Martin's pre-bankruptcy deposits and withdrawals occurred *before* 1963 (349a). Thus the overwhelming majority of the bankrupt's transaction occurred during a period in which his corporation was fully operative and during which it maintained a general ledger reflecting all of the bankrupt's transactions (221a).

Moreover, the District Court's statement that the bankrupt's "own testimony" establishes that the corporate records did not contain data for the relatively insignificant post-1962 transactions is completely inaccurate (365a). When the bankrupt was asked about transactions which took place in 1963, he stated that the answer could be found by checking the records of his corporation for that year (239a). This is because the real purpose of Robert A. Martin Associates, of which the bankrupt was President and 80% owner, had always been to serve as a vehicle for and ledger of the bankrupt's personal transactions. While it is true that the corporation may have "ceased doing business" in late 1962 or early 1963, this represented a termination of only its public operations (~~211a~~ 327a) which had always been secondary and rather limited. The bankrupt's undisputed testimony indicates that the corporate records continued to serve as a ledger for his personal transactions into 1963 when virtually all of the post-1962 transactions took place.

The referee himself cites the rule of law that production of corporate records will not suffice where the bankrupt engaged in *substantial* business not reflected on the corporate books (352a) (emphasis added). That rule of law is simply not applicable to this case where such an overwhelming majority of the bankrupt's personal transactions were recorded on his corporate books and were made available to the trustee. Moreover, the rule of law cited by the referee derives from the case of *In re Muss*, 100 F.2d 395 (2d Cir. 1938). There, as the referee himself pointed out, two-thirds of the bankrupt's assets were outside his investments in the corporations whose records he wished to substitute for his own, and the bankrupt also had conducted business through a third corporation which had kept *no* books. There could not be a more striking contrast to the case at bar where the corporation was by far the bankrupt's largest single asset and where its corporate ledger contained a complete record of all of the bankrupt's purchases and sales as well as every transaction between him and the corporation (212a, 221a).

In summary, it is clear that the two reasons given by the referee for considering the bankrupt's corporate records to be insufficient were clearly erroneous. First, his statement that the trustee's accountant examined the corporate records is plainly inconsistent with the record. Second, his conclusion that the bankrupt's corporate records do not include significant transactions of the bankrupt is belied by his own chart, which clearly indicates that the overwhelming majority of Mr. Martin's transactions took place during a period when his corporation's ledger recorded all of his personal transactions. In view of these errors, this Court must reverse the referee's decision and hold that the trustee's inexcusable failure to examine records which fully explained the bankrupt's transactions estops him from contending that the bankrupt's records were not adequate.

Point II

The bankrupt should not be denied his discharge because his personal records were lost through no fault of his own.

It has already been shown that the bankrupt kept comprehensive corporate records which were disregarded by the trustee's accountant. It had been the bankrupt's understanding that his checkbook stubs for 1960 through 1963 had been shipped together with those corporate records (219a). The bankrupt did not learn that the trustee had failed to receive the personal records until one of his examinations (271a). He then searched the trustee's accountant's office but was not able to locate the check stubs (271a).

In his decision, the referee concluded that the loss of books and records is not a justifiable excuse for failing to produce such records even when the bankrupt was not responsible for such loss.

Specifically, the referee stated:

> "The bankrupt's claim that records vital for an understanding of his financial transactions were lost in transit from the warehouse or otherwise disappeared is not acceptable. The duty to preserve such records is his and his alone until they are delivered into the custody of the trustee or his agent." (351a).

When the above conclusion was disputed on appeal, the District Court judge failed even to consider the issue. He held that the referee's decision was a finding of fact that the bankrupt's personal records had not been lost in transit, rather than a conclusion of law that such a loss is not a justifiable excuse for failing to produce books and records. (364a).

We submit that the District Court's interpretation of the referee's language is inaccurate. It is a well-established principle that questions concerning the allocation of duties under a particular statute are questions of law. The referee's language clearly indicates that he was assuming that the bankrupt's personal records *were* lost in transit (a fact never challenged at the hearing) but that such an excuse was not *legally* acceptable under the Bankruptcy Act. The decision of the referee, therefore, was based upon his interpretation of the allocation of duties under the Bankruptcy Act, which is a matter of statutory construction and, therefore, a question of law.

Having shown that the referee's decision regarding the loss of records was a legal conclusion and thus worthy of consideration on appeal, we can now discuss the lack of merit in that decision. The referee's conclusion that the nonculpable loss of records is not a justifiable excuse for failing to produce such records is based upon his faulty interpretation of the Bankruptcy Act. Specifically, the referee's language was as follows:

> "This is a proceeding relating to the bankrupt's discharge, and the entire thrust of the inquiry is whether the bankrupt's financial condition and business transactions can be ascertained from the books and records which the bankrupt *kept* and *preserved*" (346a) (court's emphasis).

The referee's emphasis on the phrase "kept and preserved" can only be interpreted to mean that he continued to place the burden of producing the records on the bankrupt even after he had relinquished control of them. However, it has been held that the Bankruptcy Act requirement of "preserving" records is synonomous with and adds nothing to the requirement of "keeping" them. Specifically, in *In re Williams*, 66 F. Supp. 157, 158 (E.D. Pa. 1946), where the bankrupt had abandoned his premises causing the loss of some records, the court reversed the denial of discharge because the referee had incorrectly *"construed the word 'preserve' to mean retrieve."*

In the case at bar the bankrupt took the extra precaution of shipping his records to a warehouse, rather than merely abandoning the premises as did the bankrupt in *Williams*. Certainly, he should not be penalized for this decision to involve a responsible third party for the transmission of his records to the trustee. In *Gross v. Fidelity and Deposit Company of Maryland*, 302 F.2d 338 (8th Cir. 1962), the court, citing *Collier on Bankruptcy* and *Remington on Bankruptcy*, stated:

> ". . . there is authority for the proposition that a discharge should not be refused if the destruction of books and records *is the result of an accident or the act of a stranger or third person over whom the bankrupt has no control."* (emphasis added) 302 F.2d 338, 341.

Furthermore, it must be re-emphasized that the loss of Mr. Martin's personal records deprived the trustee of but *one* source to explain the bankrupt's transactions. There still remained the comprehensive records of the bankrupt's personal corporation which the trustee's accountant admits he "didn't look into." (170a). Moreover, there was the bankrupt himself, whose repeated offers to explain any item were ignored by the trustee (213a).

Point III

The unreasonable delay of the trustee in contesting the discharge was intended to pressure the bankrupt and unduly prejudiced him.

In the case at bar there was a lapse of over 3½ years from the time the bankrupt filed his petition to the time the trustee filed his objections. Such a long delay in filing objections to discharge is not acceptable when the bankrupt shows that the delays *"were intended to place him under pressure or that he has been prejudiced thereby." Keenan v. Builders Appliance, Inc.*, 384 F. Supp. 14, 16 (E.D. Wisc. 1974) (emphasis added).

Here, the referee himself indicated that the trustee's delays *were* intended to place the bankrupt under pressure. Specifically, the following was the referee's response when after years of examinations and delays, the trustee requested yet another adjournment:

> "THE REFEREE: I am not adjourning any further as far as Mr. Martin is concerned. If you do not want to examine him today I will close the examination.
>
> There comes a point where it becomes harassment. It is not an examination any more, it is now harassment. This man has been examined, examined and examined, time and again. He may have been a little difficult at times but that has nothing to do with it. He did appear and he was examined. This case is on, I think, almost four years.
>
> You have had every single opportunity to tear this case apart in little pieces, and this man is dragged back again and again and again. I think this is using the Bankruptcy Court to persecute somebody and I won't permit it." (14a, 15a).

Moreover, the very nature of the objections to the discharge served to make such delays extremely prejudicial to the bankrupt. Specifically, the objection to the bankrupt's discharge was that he failed to *keep and preserve* records from which his financial condition prior to bankruptcy could be determined. This objection, however, hinged not only on the presence of books and records but also on the explanations of the bankrupt himself. As stated by the court in *Burchett v. Myers,* 202 F.2d 920, 926 (9th Cir. 1952), a bankrupt must have books and records *"which together with recollections and explanations of the bankrupt* would form the basis for a reasonably accurate and complete accounting of his business affairs." (emphasis added).

Prior to the hearing, however, the trustee sought *no* information from the bankrupt despite the bankrupt's *repeated* offers to explain his transactions (213a). Instead, he waited until a hearing in *1971* to demand explanations of isolated individual transactions which had occurred *more than ten years previously* (252a). The inequity of this delay was compounded by the fact that the bankrupt was asked to respond to these detailed inquiries without the aid of records which he repeatedly stated were necessary (233a, 239a, 241a, 267a). Even witnesses who might have been called earlier were not available to the bankrupt. In view of these circumstances, the delay by the trustee was unreasonable, for it unduly prejudiced the bankrupt in his attempt to explain transactions which he could have clarified had he only been asked to do so while they were still reasonably fresh in his mind.

It is true that part of the delays in this proceeding was caused by the bankrupt's good faith attempt to settle claims of certain creditors. But surely there could not be a more striking contrast between this legitimate reason for delaying an appeal and the devious purpose of harassment which the referee himself described as motivating the trustee's procrastination. In reviewing the harsh effect of these delays on the bankrupt and in deciding whether he deserves a discharge, the court should consider the following language in *Matter of Fithian,* 156 F. Supp. 877, 879 (D. Md. 1957):

> "A primary purpose of the Bankruprcy Act is to enable a bankrupt who is entitled to a discharge to obtain such discharge promptly and to re-establish himself in business. Trustees must be diligent in pursuing their investigations and conducting the necessary examinations."

In this case the trustee has failed to meet his obligation under the Bankruptcy Act to pursue his investigations expeditiously. The reaction of the court to this lack of diligence should not be to punish the bankrupt. This is particularly true in light of the undisputed testimony of the bankrupt that during these delays his repeated offers to clarify any or all of his financial transactions were ignored by the trustee (213a).

CONCLUSION

Upon the foregoing grounds, it is respectfully urged that the decision of the District Court affirming the referee's denial of discharge be reversed, the specification dismissed, and the bankrupt given his discharge.

Respectfully submitted,

s/ Robert A. Martin

HOFHEIMER, GARTLIR,
GOTTLIEB & GROSS
Attorneys for Bankrupt-Appellant

Bernard Gartlir
Of Counsel

CERTIFICATE OF SERVICE

Re:
Martin - Bankrupt

STATE OF NEW JERSEY :
: ss.:
COUNTY OF MIDDLESEX :

I, Muriel Mayer, being duly sworn according to law, and being over the age of 21 upon my oath depose and say that: I am retained by the attorney for the above named Bankrupt Appellant

That on the 20th day of December, 1976, I served the within

Brief and Appendix for Appellant

in the matter of Martin - Bankrupt

upon Finley, Kumble, Heime, Underberg & Grutman, Esqs., 425 Park Avenue, New York, New York

by depositing two (2) true copies of the Brief and 1 copy of Appendix ~~the same~~ securely enclosed in a post-paid wrapper, in an official depository maintained by the United States Government.

Muriel Mayer
Muriel Mayer

Sworn to and subscribed
before me this 20th day
of December 1976.

Lorraine Leotta
A Notary Public of the
State of New Jersey.
LORRAINE LEOTTA
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires April 13, 1977